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# WILL PUBLIC MANAGEMENT DRIVE OUT PUBLIC ADMINISTRATION?

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*The public management approach to public sector reform has had such an appeal that it must be examined more closely. It raises a number of key issues about the public sector to which it offers answers that are radically different from the public administration framework. The management state may have pros when compared with the administrative state, but there are cons involved when one takes several evaluation criteria into account.*

## Introduction

The discipline of public administration is again in crisis. This time the challenge comes from the management paradigm derived from the discipline of business administration. The management approach is said to hold the promise of future public sector reform, replacing the administrative approach traditionally provided by public administration. Combining the management perspective with a focus on the public sector results in a new paradigm: public management.

The response to the management challenge has been quick. Courses and programmes as well as whole institutes and schools are adapting, changing labels from 'public administration' to 'public management.' The transition from a public administration approach to a public management approach appears to be the proper move in relation to increasing demands for efficiency in the public sector. The rise of the management perspective reflects the growing saliency of market values for the public sector.

A word of warning is necessary, for there are both pros and cons with management models. The public administration approach takes care of certain aspects of the public sector that cannot be neglected. The management state is not on all criteria of evaluation superior to the

administrative state. The relevance of market values in the reform of the public sector cannot be denied, but one can question whether transforming the public sector into a set of internal markets is the right way to approach public sector reform, where internal markets are taken to mean the employment of bidding for the provision of all goods and services in the public sector.[1]

## The Market Drive

Market values have been on the increase in terms of attraction and relevance since the early 1980s. They have underpinned the calls for reform in all the major parts of the public sector. This applies generally to the OECD countries, with the possible exception of Japan where it is realised that the severe ageing problem will call for more rather than less public expenditure. However, in the Westminster state, the Napoleonic state and the Nordic and German welfare states, market ideals drive public sector reforms.

The emergence of the management perspective forms one part of the market drive. It is orientated towards the production or provision of goods and services in the public sector, calling for a different style of organisation and leadership which is to be founded on internal markets. In other parts of the public sector there is similarly a quest for market values (see Table 1).

**Table 1**
**Market Approaches and the Public Sector**

| Public sector functions | Market approach |
|---|---|
| Public resource allocation | Management |
| Public enterprises | Privatisation |
| Income redistribution | Incentive compatibility schemes |
| Public regulation | Deregulation |
| Macroeconomic policy-making | New classical economics |

In the public sector in the countries with advanced economies, the size of public resource allocation is substantial and there is a considerable number of public enterprises. The amounts of resources allocated by governments at various levels constitute some 15-25 per cent of the Gross National Product, and the number of employees in public enterprises run into hundreds of thousands in most countries. The management approach lays claim to vast resources.

The market drive has also touched the other parts of the public sector. Musgrave distinguishes between various branches of government.[2] The redistribution branch, comprising income maintenance and transfer payments, does not involve much of the management approach. Instead, the crucial thing that the market drive calls for here is incentive compatibility, or the notion that social security systems do not produce or stimulate the problems that they are supposed to counteract, such as unemployment. There is a risk of moral hazard and adverse selection in public insurance schemes, meaning that these expenditures will gain a momentum of their own, with individuals looking for opportunities to use income maintenance schemes for their self-interest purposes.

In Musgrave's stabilisation branch, the new classical economics paradigm calls for a different role of government in the economy. Macro-economic policy-making, it is argued, has to recognise that markets clear much faster than what Keynesianism implies and anticipates the fiscal and monetary policies of governments to an extent not understood earlier. Governments can only have a limited impact upon the macro-economic aggregates, and so can only in the short run operate by means of surprise action.[3]

The market philosophy questions public regulation in an all out manner. First-best solutions in the economy can only be achieved by means of competition. Public regulatory schemes in the field of natural monopolies or infrastructure will always result in second-best solutions which are not attractive.[4]

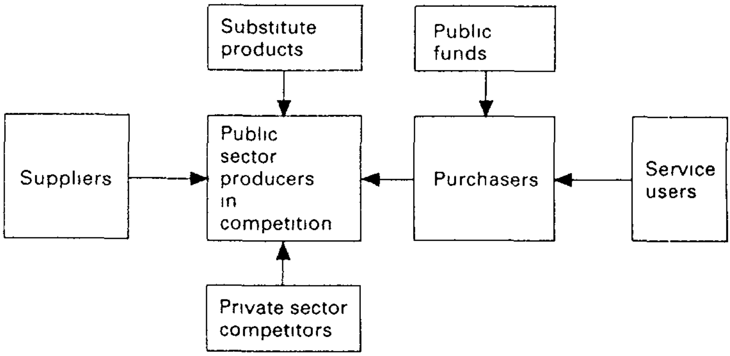
Here, the focus is on the management approach and its relevance for public resource allocation. One should note that the market values drive is not a coherent philosophy. It involves alternative strategies which may come into conflict with each other. Thus, the quest for management is different from the drive towards privatisation. Public

management represents an attempt to reform the public sector from within, whereas privatisation implies that functions can and should be hived off from the public sector. Public management calls for the replacement of the public administration perspective while retaining a large public sector. Similarly, it implies that public enterprises should be turned into companies, but still owned by the state.

The management approach favours internal markets, whereas the privatisation approach argues that external markets are more efficient. When engaging in public sector reform, especially in Mugrave's allocative branch of government, one may consider hiving off the provision of goods and services to the private sector instead of replacing public administration with public management.

One can look upon the emergence of the fully fledged management approach as the end point of the search for an alternative way of organising the public provision of goods and services. It started with a rejection of the rational planning model, moved on to the call for decentralisation and an orientation towards results, in order to end up in the radical call for the introduction of internal markets within the state and local governments, replacing Weberian hierarchy with short-term contracting and bidding (see Figure 1).

**Figure 1**
**The Management State and Internal Markets**




Source: Norman Flynn, *Public Sector Management*, second edition (London: Harvester Wheatsheaf, 1993), p. 99.

The transformation of the public sector into a set of internal markets according to the structure outlined in Figure 1 would maximise the power and discretion of public managers. They would sit at both ends of the table, as purchasers and as suppliers, engaged in bidding and short-term contracting. The typical feature of the Weberian bureau mode, one provider tied up on long-term contracts, would be replaced by competition between many suppliers. The new ideas of replacing hierarchy with bidding all over the public sector - as a form of market testing - would undo or narrow the relevance of the public administration approach.

What, then, are the distinctive differences between the management approach and the public administration framework?

## Public Administration versus Public Management

Many would react immediately to this heading by calling attention to the fact that public administration as a scholarly approach was never a monolithic enterprise. There was always heavy infighting or competition between various paradigms and schools. The discipline of public administration has been practical and adaptive, rejecting formal modelling and a scientism.

Yet, however multifarious public administration is and has been, it adheres to a few core beliefs about the public sector. These core principles may not be entirely consistent with each other, but they constitute a perspective on the state which is quite distinct (see Table 2). The public administration approach outlines a few principles that capture how state and local governments are or should be operating in countries with advanced economies. The distinction between *is* and *ought* is fundamentally confused in the public administration approach, as it is at the same time both a theoretical and a practical discipline.

The public administration approach is a loose framework for the organisation of government bureaux, what is called 'administration' in the public sector. The approach covers a large number of different models which are not necessarily in harmony with each other. But taken together these principles structure the administrative state in contradistinction to the management state as recommended by the

management approach.

The public administration framework is based on the belief in the possibility and desirability of public administration as a real phenomenon. Drawing on several models, classical organisation theory, Weberian bureaucracy theory, public law notions and public policy models, the public administration approach states what maxims are distinctive about the public organisation of society and which maxims are the chief ones that should govern any attempt at reform. But what are the principles of public administration, and how do they relate to the basic ideas in the management framework?

**Table 2**
**Public Administration versus Public Management**

| Public administration approach | Public management approach |
|---|---|
| Rules | Objectives |
| Due process | Efficiency |
| Anticipation | Adaptation |
| Responsibility | Direction |
| Formalism: case | Innovation |
| Openness | Secrecy |
| Complaint: voice | Exit |
| Legality | Effectiveness |
| Vocation | Self-interests |
| Public interest | Profit |

Emanating from public law it is little wonder that the public administration approach focuses upon rules. The core of public law is administrative law. The public sector is the exercise of public powers or competences by various bodies, the regulation of which is a necessity in a *Rechtsstaat.* Basic constitutional principles require the rule of law, meaning legality in the activities of politicians and public sector employees.

The strong entrenchment of institutions in the public sector is the safeguard against the abuse of power and the misuse of public office and funds. Public sector activities involve rights, duties and compe-

tencies, the observation of which require due processes at various levels and functions of government. Procedures are at the core of the public sector. Legislation, executive functions and administration, and judicial processes are all rule-bound by means of a variety of institutions.

The public administration framework underlines predictability in the way the administrative apparatus operates. All the components of administrative law - delegated legislation, decision-making processes, remedies, legal controls, ombudsmen - are in place because they enhance predictability or the capacity of citizens to form stable expectations about how their affairs are to be dealt with. Predictability is a vital element in anticipation and responsibility, which are given a high priority within the public administration approach in response to citizen needs.

To enhance anticipation and responsibility, each matter in public administration is approached as a so-called case, requiring a strict set of rules on how a matter is to be dealt with in a uniform and predictable manner. The case is the information-gathering unit, where the handling of the relevant data, stored in determinate fashion, is recorded in detail. Without breaking down the operations into such a system of cases, public sector administrators and professionals cannot be held responsible and citizens cannot anticipate how they are going to be treated by public bodies.

The public administration framework implies openness in relation to its procedures. Openness is a requirement for responsibility and anticipation. With minor exceptions, the materials about a case are or ought to be available for citizens, should they wish to enquire into how a decision has been made and implemented.

The rule of law requirement implies the possibility of complaint. The decision in a case must in principle be correctible; that is, those concerned should be able to file a complaint against the outcome with an authority at a higher level in the administration, or turn to a court in order to change the decision, or receive compensation, should a wrong doing have occurred. The whole idea of a remedy or a legal control of the administration is based, again, on the idea of legality. What matters very much is how things are actually done within the public sector.

Finally, there is the public interest component in the public administration framework. It is orientated towards bringing motivation to bear on outcomes, or seeing to it that work ambitions result in good performance, meaning the output of goods and services that meet citizen demands as well as legal requirements. What drives the bureaucrat, the physician and the teacher to do their utmost in the public sector is based on the conception that service in public institutions is a vocation. The ultimate aim of organisations in the public sector is to satisfy the public interest, to provide an altruistic service to the community.

One may look upon the management approach (see Table 2) as a mirror image of the public administration framework, comprising different principles of organisation as developed within the theory of the firm. Objectives are the *raison d'etre* of private organisations, the achievement of which may be monitored by a variety of efficiency measures. An organisation in the private sector is an artificial construction to enhance certain goals for as long a period as the owners are prepared to support the organisation.

Managers are the special set of employees within organisations that take care of key decision-making functions. Their performance is measured in relation to the accomplishment of the objectives of their organisations. Managerial discretion is the key principle when structuring the management function, which involves flexibility, adaptation and giving direction. Management is not orientated towards the observation of rules. On the contrary, flexibility and adaptation require unconventional decision-making, surprise and secrecy in order to enhance innovation.

The owners of the organisation expect effectiveness from their managers, but they have to devise a contract that appeals to the self-interests of managers. The interaction between owners and managers takes place within a principal-agent relationship where there is a profit from the operations that is to be shared somehow between the owners and the employees, both acting on the basis of their self-interests.

The management approach has driven out the public administration framework when it comes to the modelling of public sector reform in countries with advanced economies. The new phrase 'public management' reflects the insertion of the management perspective

into the public sector. Efficiency is considered more important than rule obedience, effectiveness goes before legality, flexibility and adaptation are more vital than predictability and responsibility. If public operations can give a profit, then profitability is a highly relevant objective besides the public interests that are served.

The managerial revolution has crept into the public sector, increasing the role of managers, on the one hand, and reorientating governance towards the management philosophy, on the other. The managerial revolution comprises both bureaux that handle the provision of goods and services in the public sector and public enterprises. It implies that public organisations such as hospitals, schools and infrastructure departments should be run as firms and that state enterprises should be reconstituted as companies and operated as a private firm. But are the pros and cons of the management state?

## The Management State

The management approach comprises a number of models for the organisation of activities. The most radical one is the internal market model, which is given increasing attention in public sector reform. It does away with the Weberian bureau model, which it replaces with the interaction between two boards - one for purchases (demand) and the other for production (supply). Public organisations are made into production units, which have to compete for contracts with other producers on similar terms (that is, competition with regard to quantities and prices). The organisational change of public enterprises into companies owned by the state or local governments involves the same change from long-term contracting, to short-term contracting, as well as a loss of openness in procedures and more of a profitability than a public interest orientation. The management transformation of public bodies carries with it advantages but also costs (see Table 3).

Creating internal markets within the public sector increases the scope for managers to direct the provision of goods and services in accordance with clear goals that may be monitored by measuring outputs and outcomes. Managers may raise efficiency and effectiveness as well as productivity, because their discretion provides them with a scope for cost-cutting strategies. Internal markets imply short-

**Table 3**
**Pros and Cons of the Management State**

| Pros | Cons |
|---|---|
| Clear goals | Neglect of means |
| Measurement of outputs and outcomes | Insensitivity towards intangible values |
| Cost consciousness | Unresponsiveness to demand |
| Discretion | Transaction costs |
| Manpower maneuvrability | Loss of tenure |
| Separation between purchaser and producer | Small numbers problem |
| Competition in supply | Lack of demand relevation mechanisms |
| Innovation | Procedural instability |
| Motivation transparency: self-interests | Lack of institutions and democratic deficit |

term contracting on the supply side, meaning that managers will have ample space for reorganisation in the short run. Finally, managers may be paid market wages on an individual basis taking into account their individual leadership capacities. The acceptance of secret wage negotiations involving large salary differences reflects the fact that self-interest motivation is part of the core of the management approach.

The establishment of internal markets within the public sector is a rejection of the administrative state. Proper procedures count for less than efficiency in outputs and outcomes, and intangible values connected with the public sector will receive less attention. Due process values underlying the means employed in the public sector figure less prominently because they cannot be quantified or measured in terms of value: equal treatment, openness of procedures, legality and predictability.

Internal markets are based on short-term contracting or bidding and tendering on a large scale. Job security cannot be retained within such a management framework. Instead of a public budget where each

bureau is given its predetermined and fixed share subject to marginal increases or decreases, internal markets involve a separation between purchaser and producer, between whom there will be market interaction. Thus, hierarchy in budget-making will be replaced by competition in supply.

Internal markets enlarge the discretion of managers in the process of supplying goods and services. They will not be bound by earlier commitments but may make contracts with the lowest bidder. However, the internal market model will not resolve basic problems on the demand side. Consumer demand will still be channelled by means of political election, as the internal market model does not include any extensive employment of user-charges as a demand-revelation mechanism.

The strong emphasis on bidding by means of short-term contracting raises the question of transaction costs within the new management framework. Traditional budget-making in an incremental model lowered transaction costs by means of so-called standard operating procedures. Internal markets must raise transaction costs, as there will be no long-term contracts or any fixed assignment of tasks to bureaux. In internal markets, competition will go over the entire budget as there will be no base that remains protected from one year to another.

A rise in transaction costs will also raise the possibility of opportunistic behaviour within the bidding process that takes place in short-term contracting. Persons or organisations with transaction-specific assets may engage in strategic behaviour in order to raise the price for their products - the small numbers problem. The management approach promises increased efficiency in the public sector, but will it automatically achieve the conditions for optimality in resource allocation?

## Optimality Conditions

The basic purpose of introducing the management state is to enhance efficiency in public resource allocation. And the test of the internal market model is whether it really does result in Pareto-efficient outcomes, or first-best solutions. Although this is a topic for empirical

research, one may state a few reservations here awaiting the evaluation of the new management regimes that are being established in different countries in different fashions and scope.

Optimality in the public provision of goods and services requires that the marginal willingness to pay on the part of the consumer/citizen is equal to the marginal cost of producing the good or the service, as well as that marginal costs are minimized. But will internal markets (a) reveal the marginal willingness to pay, and (b) result in cost minimisation?

The answers to these optimality problems depend on how the management state scores in relation to information, motivation, and opportunistic behaviour. The management approach appears to be weak with regard to information about citizen preferences, since it does not employ user-charges. It is an open question whether managers may be hired in such a manner that they have the motivation to promote the conditions that lead to efficiency in allocation. There is a risk that high transaction costs will reduce the efficiency gains from increased competition. There is also a risk of opportunistic behaviour when short-term contracts are drawn up, as persons with transaction-specific assets will have a strategic advantage in such budgetary biddings. The role of politicians will have to change, because they have to see to that the managers themselves do not engage in opportunistic behaviour.

## Conclusion

There are many signs to the effect that public administration is about to be driven out by public management as the paradigm for interpreting the public sector, in particular in relation to problems of organisation and leadership. The trend away from the public administration framework towards the public management approach is part of the general process of public sector reform, searching for more efficiency in the delivery of goods and services by the state and local governments.

But there are drawbacks in the transformation process. The public administration framework cannot easily be replaced by the new management approach, as the former has qualities not covered by the

latter. In its most radical version, the management approach calls for the introduction of internal markets in the public sector, replacing hierarchy and long-term contracts with bidding and short-term contracts. If implemented on a large scale, internal markets will drive up transaction costs, which will erase the efficiency gains from more competition.[5]

In addition, internal markets will not be able to meet the non-pecuniary goals connected with the public sector, in particular the strong emphasis upon legality and its various values. There is more to the public sector than efficiency. How can procedural values be taken care of in the management approach, not to speak of the rights to voice, remedy and legal control? The notion of justice looms large in the public sector, but where does it fit into internal markets?

NOTES

1. Jan-Erik Lane, *The Public Sector: Concepts, Models and Approaches* (London: Sage, 1993).
2. R.A. Musgrave, *A Theory of Public Finance* (New York: McGraw-Hill, 1959).
3. K.D. Hoover, *The New Macroeconomics* (Oxford: Blackwell, 1988).
4. G.J. Stigler, ed., *Chicago Studies in Political Economy* (Chicago: University of Chicago Press, 1988).
5. O. Williamson, *Economic Organization* (London: Harvester Wheatsheaf, 1986).

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